

State Notes

TOPICS OF LEGISLATIVE INTEREST

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The Ups and Downs of Michigan's Tax Burden **by David Zin, Economist**

In June 2000, Michigan employment began declining as the nation began to enter a recession. Tax revenue, on a year-over-year basis, began exhibiting consistent declines as the employment situation worsened and a variety of tax cuts continued to be implemented. Despite a forecasted improvement in the economy during 2004 and 2005, Michigan's combined General Fund and School Aid Fund revenue in fiscal year (FY) 2004-05 is expected to be 4.4% below FY 1999-2000 revenue. While employment declines also affected the growth of personal income, personal income continued to increase, although at a slower rate. Michigan personal income increased 0.3% in 2001, 1.5% in 2002, and 2.5% in 2003, after growth of 4.9% in 1999 and 5.8% in 2000. The combined impact of growing personal income and declining revenue indicates that the average State tax burden in Michigan has fallen in recent years.

The average State tax burden for Michigan can be calculated by dividing State tax revenue by Michigan personal income. The analysis here uses a broader measure of tax burden than just tax revenue because, in some cases, changes have been made in the State fiscal structure to replace more general tax revenue with more specific user charges and fees. In 1978, Michigan residents voted to limit constitutionally the amount of revenue the State may collect during a year. Revenue subject to the limit includes total State government tax revenue and all other State government revenue, such as fees, licenses, and interest earnings. This analysis uses the revenue subject to the constitutional limit when evaluating the tax burden in Michigan. (As a result, the issue might be more correctly characterized as an average revenue burden rather than an average tax burden, although the latter phrase will be used.)

In calculating the constitutional limit for any fiscal year, State government revenue may not exceed 9.49% of Michigan total personal income for the calendar year prior to the calendar year in which the fiscal year begins. For instance, in FY 2002-03, State government revenue could not exceed 9.49% of personal income for calendar year 2001. However, this lagged structure of comparing revenue from one period with income in a different period is not useful for calculating the average burden on residents. The analysis here compares fiscal year revenue with the corresponding fiscal year personal income.

Table 1 reports revenue subject to the constitutional limit, personal income, and the tax burden of that revenue (also depicted in Figure 1), assuming that all revenue was received from Michigan residents. Given the amount of tourism in the Michigan economy, changes in how multistate activity is allocated to Michigan under the single business tax, ownership of property by non-Michigan residents and other similar factors, the calculation overstates the burden of Michigan's tax structure on Michigan residents by an unknown amount. Disregarding the overstatement, Michigan's average tax burden has generally fallen during economic slowdowns and risen during expansions. The average burden reached its lowest level during FY 1991-92, at 6.61%, and its highest level during FY 1997-98, at 8.46%. Since FY 1997-98, the average burden has declined, to 7.9% in both FY 2001-02 and FY 2002-03. Based on the estimates from the May 2004 Consensus Revenue Estimating Conference, the



burden will continue to decline through FY 2004-05, with the average tax burden representing 7.64% of personal income in FY 2003-04 and 7.38% in FY 2004-05.

Table 1
State Revenue and Michigan Personal Income
FY 1978-79 to Estimated FY 2004-05
(dollar amounts in millions)

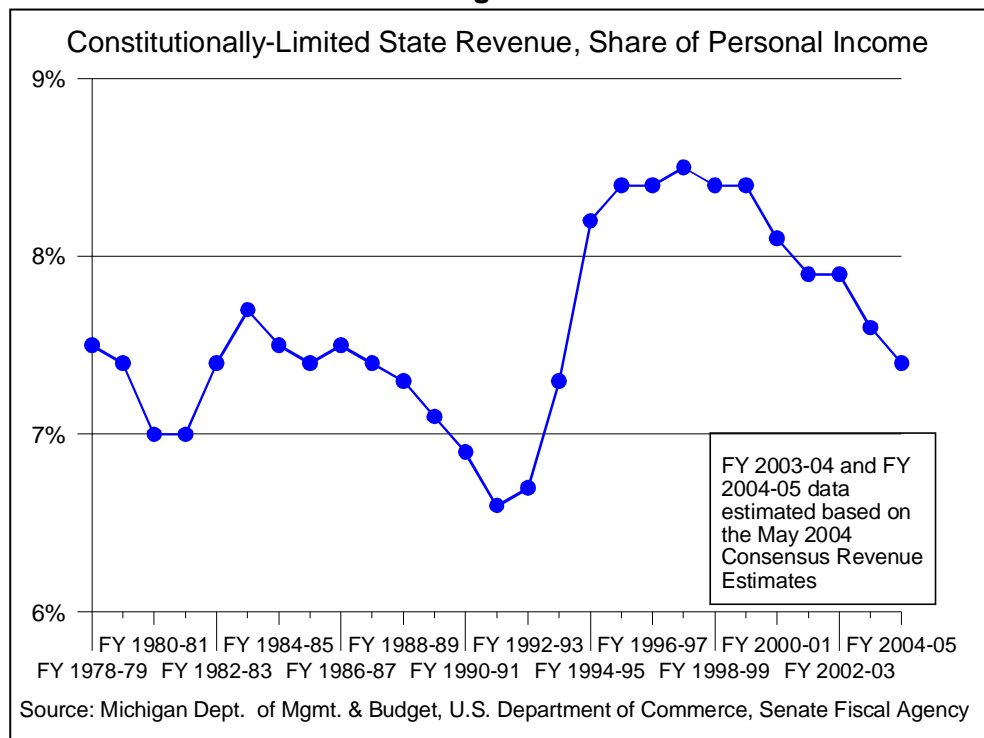
Fiscal Year	Fiscal Year Personal Income	State Revenue Subject to Constitutional Limit	Revenue Share of Personal Income
FY 1978-79	\$87,544.3	\$6,598.3	7.5%
FY 1979-80	93,264.5	6,870.1	7.4%
FY 1980-81	101,114.3	7,043.0	7.0%
FY 1981-82	104,607.8	7,348.9	7.0%
FY 1982-83	109,161.5	8,103.5	7.4%
FY 1983-84	120,635.0	9,243.5	7.7%
FY 1984-85	131,315.5	9,861.6	7.5%
FY 1985-86	140,997.5	10,483.8	7.4%
FY 1986-87	145,969.8	10,891.9	7.5%
FY 1987-88	154,343.8	11,472.3	7.4%
FY 1988-89	166,095.5	12,087.9	7.3%
FY 1989-90	174,410.8	12,363.1	7.1%
FY 1990-91	179,535.5	12,311.9	6.9%
FY 1991-92	189,585.5	12,540.9	6.6%
FY 1992-93	199,577.3	13,435.3	6.7%
FY 1993-94	213,412.5	15,473.2	7.3%
FY 1994-95	226,192.5	18,585.4	8.2%
FY 1995-96	234,309.0	19,798.8	8.4%
FY 1996-97	245,822.8	20,694.3	8.4%
FY 1997-98	260,778.3	22,072.3	8.5%
FY 1998-99	274,917.5	23,208.5	8.4%
FY 1999-00	291,484.5	24,362.9	8.4%
FY 2000-01	294,536.5	23,909.2	8.1%
FY 2001-02	298,152.5	23,546.0	7.9%
FY 2002-03	304,414.8	24,061.6	7.9%
FY 2003-04*	313,733.9	23,962.1	7.6%
FY 2004-05*	330,451.0	24,383.4	7.4%

***Note:** Estimated based on May 2004 consensus revenue estimates.

Source: Michigan Department of Management & Budget, U.S. Department of Commerce, Senate Fiscal Agency



Figure 1



Revenue subject to the constitutional limit increased significantly between FY 1992-93 and FY 1994-95 because of the adoption of Proposal A by the voters in March 1994. Proposal A transferred a significant portion of the funding for public schools in Michigan from local property taxes to the State through the imposition of a State property tax and an increase in the sales tax rate from 4% to 6%, and was supplemented by the imposition of several other new taxes and a decrease in the individual income tax rate. Virtually all of the revenue increases related to Proposal A were dedicated to the School Aid Fund, while the income tax reduction primarily affected the General Fund.

As total revenue has declined, revenue earmarked to the School Aid Fund has continued to grow. Maintaining growth in earmarked School Aid Fund revenue has meant that the average burden of supporting the School Aid Fund has remained relatively stable since the adoption of Proposal A. Given that the total average tax burden has declined while the burden of earmarked School Aid Fund revenue has remained constant, the result has been a significant decline in the burden of supporting non-School Aid Fund operations of State government ([Table 2](#) and [Figure 2](#)). The non-School Aid Fund average tax burden essentially reflects the burden of State government operations (including revenue sharing support to local units of government), and has declined in almost every year since FY 1983-84, when the burden averaged 6.07% of personal income, to an estimated 4.02% in FY 2004-05.



During the FY 1993-94 to FY 1998-99 period, non-School Aid Fund revenue (excluding the General Fund grant to the School Aid Fund) averaged 4.95% of personal income. Compared with the estimated non-School Aid Fund burden of 4.0% of personal income, FY 2004-05 taxes and fees are estimated to be \$3.1 billion below what they would have been if Michigan's burden had remained at the same level as during the mid-to-late-1990s.

Table 2

Revenue to Support School Aid Fund and Other State Spending, Share of Personal Income FY 1978-79 to Estimated FY 2004-05		
Fiscal Year	School Aid Fund Revenue	Non-School Aid Fund Revenue
FY 1978-79	2.1%	5.4%
FY 1979-80	2.0%	5.3%
FY 1980-81	1.8%	5.2%
FY 1981-82	1.6%	5.5%
FY 1982-83	1.5%	5.9%
FY 1983-84	1.6%	6.1%
FY 1984-85	1.7%	5.9%
FY 1985-86	1.7%	5.7%
FY 1986-87	1.7%	5.7%
FY 1987-88	1.7%	5.7%
FY 1988-89	1.6%	5.7%
FY 1989-90	1.7%	5.4%
FY 1990-91	1.7%	5.1%
FY 1991-92	1.6%	5.0%
FY 1992-93	1.7%	5.1%
FY 1993-94	2.2%	5.1%
FY 1994-95	3.4%	4.8%
FY 1995-96	3.4%	5.0%
FY 1996-97	3.5%	4.9%
FY 1997-98	3.5%	4.9%
FY 1998-99	3.5%	4.9%
FY 1999-00	3.5%	4.8%
FY 2000-01	3.5%	4.6%
FY 2001-02	3.5%	4.4%
FY 2002-03	3.6%	4.3%
FY 2003-04*	3.5%	4.2%
FY 2004-05*	3.4%	4.0%
*Note: Estimated based on May 2004 consensus revenue estimate.		

Source: Michigan Department of Management & Budget, U.S. Department of Commerce, Senate Fiscal Agency



Figure 2

